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Venture Capital Is a Time Bomb

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January 20, 2010

Video URL: http://ecorner.stanford.edu/videos/2354/Venture-Capital-Is-a-Time-Bomb

David Heinemeier Hansson has a provocative point of view: he believes that Venture Capital is a time bomb and one of the most harmful things for a new business. He explains that a sudden windfall of money provides start-ups with a false sense of security. VC-injected companies often lose the urgency to create a sustainable, profitable product. These companies often become addicted to venture capital funding, requiring round after round of financing.

Transcript

And I'll try to save you from one other thing which is venture capital. Venture capital is a time bomb. And realize first of all I'm talking about here is I'm talking from my experiences. I build software. Again, I don't build factories in India that cost a billion dollars. I don't have all this infrastructure cost. I don't need any of all that ramp up. I'm talking about software, Web 2.0, blah blah blah blah. In this industry, venture capital is absolutely a time bomb and it's probably the most harmful thing you can do to a new business, is to accept venture capital upfront and I'll tell you why. At first, it sounds like it's a really good idea.

If I didn't take venture capital, well, I wouldn't have any money and we would only be us three people and we would actually like, "How are we going to live?" Good question. Now, if you take venture capital, you got millions. You probably got a runway of years. You don't have to worry about tomorrow. You can worry about three years from now because tomorrow doesn't really matter. You have $5 million in the bank. Who cares? Even better. It's not your money. You get to spend other people's money for a sustained period of time and the worst that can happen is that you waste five years of your life. That's pretty bad.

Wasting five years on your life on something that doesn't work because the time bomb blew up. That's a lot worse than worrying about how you're going to make rent next week, in my mind. So, the tradeoff is sort of, are you going to have the pain now when you actually have to prove that your idea is good enough that it can be profitable and that it can be self sustainable? Or are you going to have the pain five years from now when you realize that the time bomb blew up. Now, the venture capitals own your company and they've just pushed you out and you have nothing to show for five years of effort. That's sort of the worst case scenario. But it happens a lot more often than you'd think. I've been talking to a bunch of entrepreneurs in the Web 2.0 space. A lot of them took venture capital. I have not meet a single one who wouldn't say he would do it differently if he had to start out with today. But there's not a lot of information out there about that because the problem is once you take your series A round of funding, you're an addict.

You're going to need that next fix. You're going to need series B right now. "We need some bridge capital to get it over just to the other side". And when you're in that situation and you're an addict, it's a pretty bad idea to piss off your dealer by saying, "I should never have gotten into this in the first place. I'm so sorry." No, doesn't really work. So, big warning label on venture capital.